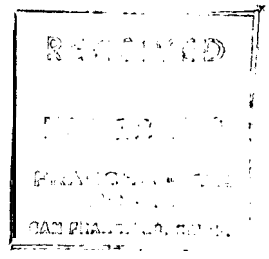
BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA



In the Matter of the Appeal of)
)
E. L. NEWELL)

Appearances:

For Appellant: Robert R. Hanley, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel; Crawford H. Thomas, Associate Tax Counsel

OPINION

This appeal is made pursuant to Section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of E. L. Newell to proposed assessments of additional personal income tax in the amounts of $624.24, $296.77 and $477.04 for the years 1948, 1949 and 1950, respectively.

The question presented is whether gain realized by Appellant from the sale of lots in the years 1948, 1949 and 1950 is taxable as ordinary income or as capital gain.

Appellant's father purchased a walnut grove of approximately 38 acres in 1915. Appellant lived upon the property and managed the operation of the grove from 1927 until his father's death in 1939. Under his father's will the grove and other assets were placed in protective trust with Appellant, his sister and his stepmother as co-trustees and equal beneficiaries of trust income. Although prohibited from alienating their beneficial interest in the trust or distributing the corpus thereof, the trustees were empowered to sell the property and to invest and reinvest the trust funds. Upon the death of the stepmother the principal is to be divided equally between Appellant and his sister. Appellant continued to live upon the property and manage the grove. He also handled the family investments and was the trustees' guiding hand in all matters pertaining to the property.

Under the trusteeship the grove produced little income and it became uneconomical to continue its cultivation. After unsuccessfully attempting to sell the entire property, the trustees decided to subdivide the land and then to sell it as residential lots. A master plan was prepared and in accordance therewith the trust proceeded to subdivide a

portion of the tract. In the course of the next three or four years, 16 lots were sold. This rate of conversion was unsatisfactory to Appellant's sister and stepmother, who were mainly concerned with increasing current income. Appellant, on the other hand, preferred to complete the subdivision according to the master plan and to sell the remainder of the tract in a piecemeal, more profitable manner.

This conflict of interests was resolved by an agreement for the purchase of the tract by Appellant in parcels to be conveyed from time to time as he was financially able to handle the transactions. Thereafter, agreements were entered into between the trust and Appellant for the sale of various parcels of seven to ten acres. The first parcel was sold to him in September 1944. The trust completed the subdividing and necessary street work on each parcel before conveying it to Appellant. This was agreed upon because Appellant did not have the cash to finance the work prior to the sale of individual lots, He agreed to pay for each parcel in monthly installments, Time was expressly made of the essence of the agreements.

Signs posted on the property by the trustees read, "For Sale By Owner", and gave the telephone number and address of the house in the grove where Appellant lived. Some of the signs also gave lot sizes, Appellant purchased and sold 90 lots in the period from September, 1944, through 1950. Forty of these were sold in eight transactions. The balance of the sales were of single lots. His total gain from sales for the three years in question was $88,133.54. This was approximately 85 percent of his gross income in those years. All except two or three of the lots were sold through brokers to whom Appellant paid commissions.

Appellant states that: "Real estate brokers were never allowed to place their signs on the property, because none of them had been hired as the owner's agent." But he did "allow brokers to submit offers, and when such offers were accepted, commissions were paid to them." Appellant further states that at no time was he engaged in the business of buying or selling real estate, that since 1926 his only activity has been the care of his investments and those of his father's trust, and that since 1942 he has spent more than half of his time in retirement at Lake Arrowhead.

The gist of Appellant's argument is:

> ". . . He agreed to buy the property, as he was able to, from the trust, so as to (1) furnish income to the trust, and (2) obtain a better

> price for the land, Prior to, and at the time of his arrangement with the the trust, there was no demand for the lots. Shortly thereafter, with the end of the war, a great building boom developed throughout the United States. This furnished an immediate market for subdivided lots. Almost from the time that Appellant began his purchases from the trust, there was a steady appreciation in the value of the lots. This appreciation came about entirely through conversion of the property from agricultural to residential use, and inflation of the real estate market. It was a capital gain on the Appellant's inheritance, and not a gain due to any personal effort of his own."

Appellant's gain is taxable as ordinary income if he held the lots "primarily for sale to customers in the ordinary course of his trade or business" (Section 17711, now 18161. of the Revenue and Taxation Code). This provision is substantially the same as that in Section 117(a)(l) of the United States Internal Revenue Code of 1939. Factors to be considered are the purpose of the taxpayer's acquisition and disposal of the property, the continuity of sales or sales related activity over a period of time, the number, frequency and substantiality of sales, and'the extent to which the owner or his agents engaged in sales activities by developing or improving the property, soliciting customers and advertising (W. T. Thrift, Sr., 15 T.C. 366).

The purpose of Appellant's acquisition of the lots was clearly to resell them, He purchased the lots from the trust from time to time as he realized sufficient income to do so. His activity in this respect is a fundamental characteristic of the ordinary business of selling.

Appellant purchased and sold 90 lots over a period of six years, an average of 15 lots a year. A business has been held to exist where less than half of this number of lots were sold each year. (Lizzie May Jackson, T.C. Memo., Dkt. No. 3114, entered April 9, 1946; Joel O'D. and Marcella G. Cornish, T.C. Memo,, Dkt. No. 53826, entered March 29, 1957.) Over the three years in question, Appellant derived from sales a gain of almost $90,000, a sum representing approximately 85 percent of his entire gross income for those years,

Apparently Appellant was able to accomplish these sales with a minimum of promotional activity. The significance of that fact is diminished where, as in this case, there was a

seller's market (Lobello v. Dunlap, 210 Fed. 2d 465, Mauldin v. Commissioner, 195 Fed. 2d 714; Arthur E. Wood, 25 T.C. 468). Appellant was under compulsion to maintain a sufficiently high rate of selling to pay the installments due the trust. He would have undoubtedly increased his efforts if the market had required it,

Of the authorities cited by Appellant, the most favorable to his position is Frieda E. J. Earley, 7 T.C. 198. This appeal, however, is materially distinguished from that case by the fact that here Appellant purchased the lots for resale.

We conclude that Appellant's gain on the sale of the lots is taxable to him as ordinary income,

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of E. L. Newell to proposed assessments of additional personal income tax in the amounts of $624.24, $296.77 and $477.04 for the years 1948, 1949 and 1950, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of Fsbruary, 1959, by the State Board of Equalization.

Paul R. Leake, Chairman

Geo. R. Reilly, Member

John W. Lynch, Member

Richard Nevins, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary